

1 PAUL B. SNYDER  
2 United States Bankruptcy Judge  
3 1717 Pacific Ave, Suite 2209  
4 Tacoma, WA 98402

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8 **January 26, 2007**

9 MARK L. HATCHER  
10 CLERK U.S. BANKRUPTCY COURT  
11 WESTERN DISTRICT OF WASHINGTON  
12 AT TACOMA  
13 \_\_\_\_\_ DEPUTY

14 **UNITED STATES BANKRUPTCY COURT  
15 WESTERN DISTRICT OF WASHINGTON AT TACOMA**

16 In re:

17 DANIEL ROBERT PROWS and KRISTY  
18 DAWN PROWS,

19 Debtors.

20 BIOBASED SYSTEMS, LLC.,

21 Plaintiff,

22 v.

23 DANIEL ROBERT PROWS and KRISTY  
24 DAWN PROWS,

25 Defendants.

Case No. 05-53919

Adversary No. 06-4111

**MEMORANDUM DECISION**

**NOT FOR PUBLICATION**

1 THIS MATTER came on for trial on January 10, 2007. In accordance with its adversary  
2 complaint, BioBased Systems, LLC. (Plaintiff), seeks to have the bankruptcy discharge of  
3 Daniel Robert and Kristy Dawn Prows (Defendants) denied pursuant to 11 U.S.C.  
4 §§ 727(a)(2)(A), (a)(4)(A), and (a)(5)(A).<sup>1</sup> Based on the evidence, testimony and arguments

25 <sup>1</sup> The Plaintiff appears to have incorrectly cited to 11 U.S.C. § 727(a)(5)(A) in its complaint; the proper citation is § 727(a)(5).

MEMORANDUM DECISION - 1

1 presented at trial, and considering the pleadings and exhibits submitted, the Court's findings  
2 of fact and conclusions of law are as follows:

3 **FINDINGS OF FACT**

4 Prior to the filing of their bankruptcy, the Defendants owned the majority of stock in and  
5 operated KD Companies, Inc. (KD). KD appeared to have operated primarily as a holding  
6 company for the stock of PolyFoam Solutions, Inc. (PolyFoam), although the evidence is  
7 unclear as to whether KD owned all or a portion of the stock. PolyFoam commenced  
8 business in June, 2003, and was engaged in the installation of polyurethane foam insulation.  
9 From the time of its incorporation through the summer of 2005, the Defendants personally  
10 contributed substantial money to PolyFoam, either as additional contributions to capital or as  
11 personal loans. In order to fund the contributions/loans made to PolyFoam, the Defendants  
12 sold rental property and liquidated their retirement accounts. The Defendants also sold their  
13 residence within a few months of filing bankruptcy, contributed the net proceeds to PolyFoam  
14 and relocated to their parents' home. By July, 2005, it was clear that PolyFoam could not  
15 survive as an independent entity and the Defendants began a liquidation of the business.  
16

17 On August 1, 2005, Daniel Prows (Defendant) completed an Application for  
18 Employment, Employment Agreement and several other employment documents with  
19 Integrated Energy Systems, Inc. (Integrated). The documents indicated that he was to be  
20 employed as the General Manager of Integrated effective August 1, 2005, earning a base  
21 salary of \$42,000 per year. Integrated was engaged in the business of buying, selling and  
22 marketing energy efficient systems for residential and commercial construction projects.  
23 Integrated had been incorporated on July 13, 2005, and was owned by the Defendant's father,  
24 Robert Prows. Robert Prows served as President and the Defendant served as Secretary of  
25

1 Integrated. A preponderance of the evidence indicates that the Defendant worked  
2 intermittently for Integrated since becoming employed on August 1, performing minor  
3 management duties, such as training foam sprayers and assisting in the organization of the  
4 company. While winding up the affairs of PolyFoam and KD, the Defendant was also working  
5 full-time as a construction manager for Salmon Creek Commons, Ltd.

6 On October 5, 2005, equipment, furnishings and miscellaneous personal property was  
7 sold by PolyFoam to Integrated for the purchase price of \$18,000. A postpetition appraisal  
8 indicated that the goods were sold at fair market value. The Defendants also either  
9 surrendered or transferred the remaining vehicles of PolyFoam in exchange for the then  
10 existing debt. Within a few months of the filing of the Defendants' bankruptcy, PolyFoam still  
11 had in excess of \$150,000 in receivables, but the Defendant testified that all collectable  
12 receivables were used by PolyFoam to pay down its outstanding debt. As the Defendants  
13 had guaranteed some of the PolyFoam debt that remained unpaid, including the debt owed  
14 Plaintiff, they filed a voluntary Chapter 7 bankruptcy petition and schedules (Petition) on  
15 October 16, 2005.

17 Plaintiff first asserts that in the Petition the Defendants did not disclose either the  
18 Defendant's employment or income from Integrated. It is also alleged that the Defendants  
19 gave away to friends and relatives, but failed to disclose in their Petition, personal property  
20 and furnishings. The Plaintiff also asserts that the Defendants failed to list their residence that  
21 was sold within one year of the filing of bankruptcy. In Schedule J to the Petition, the  
22 Defendants indicated that they paid \$2,100 in rent, \$120 in electricity and heating fuel, \$75 in  
23 water and sewer, \$75 in telephone, and \$30 in garbage and recycling charges, but did not  
24

1 disclose that they were residing with the Defendant's parents at the time and were not paying  
2 any of these monthly expenses.

3 Plaintiff also asserts that the relationship and income received from PolyFoam was not  
4 disclosed. Plaintiff alleges that it is not possible to tell from the Petition what happened to  
5 many of the assets of PolyFoam, particularly the accounts receivable. A transfer from  
6 PolyFoam to Integrated of a 2004 GMC, with equipment (Super Rig #2), was alleged to have  
7 been transferred to Integrated without adequate consideration, and it is further alleged that the  
8 Defendants failed to report a transfer of \$3,452.03 to PolyFoam made approximately 30 days  
9 before they filed bankruptcy. These funds were subsequently used to repay a PolyFoam  
10 employee, who had earlier expended funds to pay a PolyFoam debt. During the period from  
11 September 7, 2004, through August 13, 2005, the Defendants received in excess of \$91,000  
12 from PolyFoam that they labeled "reimbursements" that were presumably payments on loans  
13 given to PolyFoam. The Plaintiff argues that these amounts were salary and should have  
14 been referenced in the Petition.

16 **CONCLUSIONS OF LAW**

17 11 U.S.C. § 727(a)(2)(A)

18 11 U.S.C. § 727(a)(2)(A) generally provides that a court shall grant the debtor a  
19 discharge, unless the debtor, with the requisite fraudulent intent has permitted to be or  
20 actually transferred, removed, destroyed, mutilated, or concealed, his or her property, within  
21 one year before the date of the filing of the bankruptcy petition. Accordingly, an objection to  
22 discharge under this section requires, within one year of filing the petition, (1) a transfer or  
23 concealment, and (2) a subjective intent on the debtor's part to hinder, delay or defraud a  
24 creditor through the transfer or concealment. There must be a finding of actual intent to

1 hinder, delay or defraud creditors, as constructive intent is not sufficient. However, intent  
2 "may be established by circumstantial evidence, or by inferences drawn from a course of  
3 conduct." Consumers Oil Co. v. Adeeb (In re Adeeb), 787 F.2d 1339, 1343 (9th Cir. 1986)  
4 (quoting Bank of Sheridan, Mont. v. Devers (In re Devers), 759 F.2d 751, 753-54 (9th Cir.  
5 1985)). Section 727 is to be construed liberally in favor of debtors and strictly against the  
6 creditor. Adeeb, 787 F.2d at 1342.

7 In the instant case, it is alleged that the following transfers fall within the meaning of 11  
8 U.S.C. § 727(a)(2)(A): (1) PolyFoam personal property and equipment to Integrated for the  
9 purchase price of \$18,000; (2) miscellaneous furnishings to friends and relatives made at the  
10 time of the Defendants' relocation into the their parents' home; (3) \$3,452.03 to Polyfoam; (4)  
11 transfer of the Super Rig #2 for less than adequate consideration; and (5) concealment of  
12 PolyFoam receivables.

14 A preponderance of the evidence indicates that the sale of personal property and  
15 equipment from PolyFoam to Integrated was at fair market value, and the transfer of a de  
16 minimis amount of personal property had no real value and was given in exchange for the  
17 assistance of friends/relatives in the relocation from the Defendants' recently sold residence to  
18 the basement of the their parent's home. There was no evidence presented that a transfer of  
19 title to the Super Rig #2 was completed, as the only testimony indicated that PolyFoam was  
20 still on title to the vehicle and presumably this asset could be seized by PolyFoam creditors.  
21 The transfer of \$3,452.03 approximately 30 days before the filing of the Petition, although  
22 clearly preferential, by itself does not support a denial of the discharge under this statute. The  
23 Court finds credible the Defendant's testimony that his only intention was to reimburse a  
24 PolyFoam employee for personal funds the employee had expended to pay an outstanding

1 PolyFoam debt. Lastly, the Plaintiff did not establish by a preponderance of the evidence that  
2 PolyFoam receivables were used for any other purpose than the payment of PolyFoam debt.  
3 In each of these above instances, the Court has been presented with insufficient evidence  
4 that the Defendants had the requisite intent to defraud or deceive creditors at the time of the  
5 transfer. Accordingly, a violation of 11 U.S.C. § 727(a)(2)(A) has not been established.  
6

7 11 U.S.C. § 727(a)(4)(A)

8 11 U.S.C. § 727(a)(4)(A) provides that a court should grant a discharge to a debtor,  
9 unless the debtor knowingly and fraudulently, in or in connection with the case, made a false  
10 oath or account. For purposes of this section, proof that the debtor merely omitted information  
11 from bankruptcy schedules is not sufficient to establish fraudulent intent on debtor's part. La  
12 Brioche, Inc. v. Ishkhanian (In re Ishkhanian), 210 B.R. 944, 956 (Bankr. E.D. Pa. 1997). To  
13 deny a debtor a discharge under § 727(a)(4)(A), the plaintiff must show that (1) the debtor  
14 knowingly and fraudulently made a false oath; and (2) the false oath related to a material fact.  
15 Thomas v. Aubrey (In re Aubrey), 111 B.R. 268, 274 (9th Cir. BAP 1990). “[O]nce it  
16 reasonably appears that the oath is false, the burden falls upon the [debtor] to come forward  
17 with evidence that he has not committed the offense.” Boroff v. Tully (In re Tully), 818 F.2d  
18 106, 110 (1st Cir. 1987) (quoting In re Mascolo, 505 F.2d 274, 276 (1st Cir. 1974)).  
19

20 As with 11 U.S.C. § 727(a)(2)(A), intent may be inferred from the actions of the debtor.  
21 A party objecting to a debtor's discharge on false oath grounds must establish “that the  
22 information was omitted for the specific purpose of perpetrating a fraud and not simply  
23 because [a] debtor was careless or failed to fully understand his attorney's instructions.”  
24 Estate of Perlinder v. Dubrowsky (In re Dubrowsky), 244 B.R. 560, 571-72 (E.D. N.Y. 2000).  
25 While some courts have found the requisite intent where there has been a pattern of falsity or

1 from a reckless indifference to the truth, the ultimate question is still whether fraud has been  
2 established. Tully, 818 F.2d at 112.

3 "A false statement is material if it bears a relationship to the debtor's business  
4 transactions or estate, or concerns the discovery of assets, business dealings, or the  
5 existence and disposition of the debtor's property." Fogal Legware of Switzerland, Inc. v.  
6 Wills (In re Wills), 243 B.R. 58, 62 (9th Cir. BAP 1999) (citing In re Chalik, 748 F.2d 616, 618  
7 (11th Cir. 1984))

8 Initially, the Defendant omitted from his Statement of Affairs both his employment and  
9 earnings from Integrated. The evidence is clear that he earned compensation (in excess of  
10 \$11,000 through December 31, 2005) from Integrated as an Integrated employee prior to,  
11 during and after the filing of his Petition. The Court does not find credible the Defendant's  
12 testimony that such amounts were not wages, but reimbursements or payroll advancements.  
13 Exhibits such as the Defendant's W-2 establish that he was receiving compensation that  
14 should have been reported in his Petition. Neither his earnings nor the Integrated  
15 employment was scheduled. These omissions are material as they concern the Defendant's  
16 business relationship and possibly could lead to the discovery of additional or dissipated  
17 assets.

18 The Defendants fraudulently listed rent and utility expenses in Schedule J, that both of  
19 them must have been aware were not paid. The listing of such amounts is both substantial  
20 and material, and the Defendant's explanation that these amounts were listed because he  
21 intended to reimburse his parents lacks proof and is not credible. Schedule I and J figures are  
22 important to a U.S. Trustee's determination of substantial abuse under 11 U.S.C. § 707(b),  
23  
24

1 and raise questions as to where the Defendants spent their income if not for these expenses.  
2 This could possibly lead to the discovery of further estate assets.

3 The failure to list on their Petition the transfers of a de minimis amount of personal  
4 property to friends/relatives for no consideration, the failure to list \$3,452.03 as a preferential  
5 transfer, or the sale of the Defendants' residence within one year of filing bankruptcy, alone,  
6 are not actionable under 11 U.S.C. § 727(a)(4)(A). This is particularly true with regard to the  
7 sale of the Defendants' residence, because the Defendants' attorney was admittedly aware of  
8 the sale. The Defendants, and not their attorney, have the ultimate responsibility to ensure  
9 that all of the information is correctly disclosed on their bankruptcy petition and schedules,  
10 and these omissions, when considered together, lend credence to the Court's conclusion that  
11 the Defendants exhibited a pattern of nondisclosure that was either fraudulent or indicative of  
12 a careless disregard of the truth in completing their Petition. The Plaintiff is found by a  
13 preponderance of the evidence to have established that the Defendants knowingly and  
14 fraudulently omitted material information from their bankruptcy Petition.

16 11 U.S.C. § 727(a)(5)

17 11 U.S.C. § 727(a)(5) provides that "[t]he court shall grant the debtor a discharge,  
18 unless . . . the debtor has failed to explain satisfactorily, before determination of denial of  
19 discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's  
20 liabilities." "Section 727(a)(5) is broadly drawn and clearly gives a court power to decline to  
21 grant a discharge in bankruptcy where the debtor does not adequately explain a shortage,  
22 loss, or disappearance of assets." First Federated Life Ins. Co. v. Martin (In re Martin), 698  
23 F.2d 883, 886 (7th Cir.1983) (citing Baum v. Earl Millikin, Inc., 359 F.2d 811 (7th Cir. 1966)).  
24 "While the burden of persuasion rests at all times on the creditor objecting to the discharge, it  
25

1 is axiomatic that the debtor cannot prevail if he fails to offer credible evidence after the  
2 creditor makes a *prima facie* case." First Tex. Sav. Ass'n v. Reed (In re Reed), 700 F.2d 986,  
3 992 (5th Cir.1983). "A debtor's failure to offer a satisfactory explanation when called on by the  
4 court is a sufficient ground for denial of discharge under section 727(a)(5)." Devers, 759 F.2d  
5 at 754. Constructive intent is not enough. However, intent "may be established by  
6 circumstantial evidence, or by inferences drawn from a course of conduct." Adeeb, 787 F.2d  
7 at 1343 (quoting Devers, 759 F.2d at 753-54).

8  
9 In the instant case, there is not a preponderance of the evidence that would establish  
10 that the Defendants failed to account for any valuable personal assets. It could be argued  
11 that the Defendants did not adequately explain the liquidation or distribution of the assets of  
12 PolyFoam or KD; however, the Plaintiff was unable to establish with particularity that any of  
13 the corporate assets were not accounted for or should have been disclosed in the Petition.  
14 This is particularly true as the bankruptcy filing was personal and not corporate. No evidence  
15 was admitted by either party that established the existence of corporate assets that were  
16 transferred improperly. The Plaintiff is not found by a preponderance of the evidence to have  
17 established that the Defendants were in violation of 11 U.S.C. § 727(a)(5).

18 DATED: January 26, 2007

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21 Paul B. Snyder  
22 U.S. Bankruptcy Judge